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REPORT TO THE LEGISLATURE

MONTANA AGRICULTURAL LOAN AUTHORITY

DEPARTMENT OF AGRICULTURE

Report on the Examination of Financial Statements
Fiscal Year Ended June 30, 1986

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86-37

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STATE OF MONTANA

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122

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LEGISLATIVE AUDITOR

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JAMES GILLETT
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PERFORMANCE AUDITS

LEGAL COUNSEL:
JOHN W. NORTHEY

September 1986

The Legislative Audit Committee
of the Montana State Legislature:

This document is the result of our audit of the Montana Agricultural Loan Authority of the Department of Agriculture. We performed the audit solely for the purpose of expressing an opinion on the authority's financial statements. Any findings disclosed by our audit were discussed with management and will be appropriately reported as part of our scheduled audit of the Department of Agriculture. Therefore, this report contains no recommendations. We would like to thank the director, his staff, and the authority personnel for their cooperation and assistance during the audit.

Respectfully submitted,

Scott A. Seacat
Legislative Auditor

TABLE OF CONTENTS

	Page
Appointive and Administrative Officials	ii
Introduction	1
Background	1
Auditor's Opinion Letter and Authority Financial Statements	
Summary of Audit Opinion	
Auditor's Opinion Letter	3
Balance Sheet - Enterprise Fund, June 30, 1986	5
Statement of Revenues, Expenses, and Changes in Retained Earnings - Enterprise Fund for the Fiscal Year Ended June 30, 1986	6
Statement of Changes in Financial Position - Enterprise Fund for the Fiscal Year Ended June 30, 1986	7
Notes to Financial Statements	8
Agency Response	

APPOINTIVE AND ADMINISTRATIVE OFFICIALS

MONTANA AGRICULTURAL LOAN AUTHORITY

		Term Expires
Paul Ringling, Chairman	Miles City	January 1, 1987
Dennis DeVries	Polson	January 1, 1987
Dave Gorton	Billings	January 1, 1987
Terry Murphy	Great Falls	January 1, 1987
Dixie Halvorson	Scobey	January 2, 1989
Bernard Harkness	Dell	January 2, 1989
Keith Kelly	Helena	January 2, 1989
Dennis Robinson	Lewistown	January 2, 1989
Harry Rodenburg	Wolf Point	January 2, 1989

AUTHORITY STAFF

Michael Murphy, Administrator

Jeanette DeWolf, Secretary

INTRODUCTION

We performed a financial audit of the Montana Agricultural Loan Authority (the authority) for the fiscal year ended June 30, 1986. The objective of the audit was to determine if the authority's financial statements present fairly the financial position at June 30, 1986, and the results of operations for the year then ended.

BACKGROUND

The Montana Agricultural Loan Authority was established by Chapter 580, Laws of 1983. Chapter 448, Laws of 1985, established the loan guarantee program whereby the authority may guarantee and make commitments to guarantee payments required by authority funded loans. The authority is attached to the Department of Agriculture (the department) for administrative purposes. Financial accounting for the authority is performed by the department's Centralized Services Division. The authority is responsible for administering the following two programs.

The Beginning Farm Loan Program is a tax-exempt bond program designed to assist beginning Montana farmers and ranchers purchase agricultural land, agricultural improvements, and depreciable agricultural property. Applications for the loans are approved by the authority and a participating financial institution (the lender). Non-recourse bonds issued by the authority are purchased by the lender and the bond proceeds are used to finance the loan. This loan is collateral for the tax-exempt bond. The tax-free interest on the bonds enables the lender to offer a lower interest rate to the farmer. Terms of each bond are set to reflect exactly the terms of each respective loan. During fiscal year 1985-86, the authority approved no loans and no bonds were issued. Bond terms provide that neither the state nor the authority assumes obligation for their repayment.

The Tax Deduction on Sale of Agricultural Land Program provides for a state tax deduction to the seller of agricultural land if the sale is made to a qualified beginning farmer. The sale

transaction must be approved by the authority. The seller makes application to the authority for the tax deduction within one year of the closing of the sale. As of June 30, 1986, one application for tax deduction was pending.

Section 80-12-401, MCA, requires an annual audit of the financial activity of the authority. This is the third audit of the authority. During the initial year of operations the authority received no applications for loans. Therefore, no revenues were generated and the authority sustained an operating loss for the fiscal year ended June 30, 1984.

The authority also sustained an operating loss in fiscal years 1984-85 and 1985-86. We considered additional factors that raised questions related to the authority's operations. Department personnel indicated that between $3 and $4 million in loans must be issued each year to support the program. At this time, two bonds have been issued and one loan application is pending. According to department officials, the current economic situation in agriculture has hindered the development of the program. Federal restrictions on beginning farmer eligibility further limit potential applicants. Pending federal legislation would remove some limitations, but passage is uncertain. Evaluation of these factors raises questions about the continued viability of the Montana Agricultural Loan Authority as it is presently structured.

AUDITOR'S OPINION LETTER

AND AUTHORITY FINANCIAL STATEMENTS

SUMMARY OF AUDIT OPINION

The auditor's opinion issued in this report is intended to convey to the reader of the financial statements the degree of reliance which can be placed on the amounts presented. We issued a qualified opinion on the financial statements of the Montana Agricultural Loan Authority. The reader may place reliance on the amounts presented in these financial statements subject to the issue of the authority's continued existence.

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LEGAL COUNSEL:
JOHN W. NORTHEY

The Legislative Audit Committee
of the Montana State Legislature:

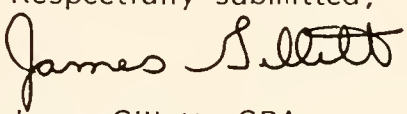
We have examined the Balance Sheet - Enterprise Fund as of June 30, 1986, and the related Statement of Revenues, Expenses, and Changes in Retained Earnings and the Statement of Changes in Financial Position of the Montana Agricultural Loan Authority for the fiscal year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and other such audit procedures as we deemed necessary in the circumstances.

As shown in the financial statements, the authority incurred a net loss of $31,203 during the fiscal year ended June 30, 1986. As of that date, the authority's total liabilities exceeded total assets by $128,618. These factors, among others, as discussed in Note 6, indicate the authority may be unable to continue in existence. The financial statements do not include any adjustments which might be necessary should the authority be unable to continue in existence.

In our opinion, subject to the effects on the financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainty relating to the authority's continued existence referred to in paragraph two been known, the financial statements referred to above present fairly the financial position of the Montana Agricultural Loan Authority Enterprise

Fund as of June 30, 1986, and the results of its operations and the changes in its retained earnings for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Respectfully submitted,



James Gillett, CPA
Deputy Legislative Auditor

September 2, 1986

MONTANA AGRICULTURAL LOAN AUTHORITY
DEPARTMENT OF AGRICULTURE
BALANCE SHEET - ENTERPRISE FUND
JUNE 30, 1986

Assets	
Cash	$ 24,180
Equipment	
(net of accumulated depreciation of $244)	1,251
Total Assets	$ 25,431
Liabilities and Fund Equity	
Liabilities	
Accounts Payable	$ 444
Due to Other Accounting Entities	9,674
Inter-entity Loans Payable	142,190
L.T. Liability - Compensated Absences	1,741
Total Liabilities	154,049
Fund Equity	
Retained Earnings	(128,618)
Total Fund Equity	(128,618)
Total Liabilities and Fund Equity	$ 25,431

The notes to the financial statements are an integral part of this statement.

MONTANA AGRICULTURAL LOAN AUTHORITY
DEPARTMENT OF AGRICULTURE
STATEMENT OF REVENUES, EXPENSES, AND
CHANGES IN RETAINED EARNINGS
ENTERPRISE FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 1986

Operating Revenue:	
Application Fees	$ 200
Total Operating Revenue	200
Operating Expenses:	
Personal Services	12,651
Contracted Services	7,256
Supplies and Materials	273
Communications	2,190
Travel	614
Rent	1,406
Repair and Maintenance	13
Other Expenses	7,018
Total Operating Expenses	31,421
Prior Year Expenditure Adjustment	18
Net Income (Loss)	(31,203)
Retained Earnings, July 1, 1985	(126,546)
Prior Period Adjustment	29,131
Retained Earnings, Restated	(97,415)
Retained Earning, June 30, 1986	$(128,618)

The notes to the financial statements are an integral part of this statement.

MONTANA AGRICULTURAL LOAN AUTHORITY
DEPARTMENT OF AGRICULTURE
STATEMENT OF CHANGES IN FINANCIAL POSITION
ENTERPRISE FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 1986

Sources of Working Capital:	
Operations:	
Net Income (loss)	$(31,203)
Items not Requiring Working Capital:	
Prior Period Adjustment	29,131
Add Depreciation	244
Working Capital Provided by Operations	(1,828)
Uses of Working Capital	-0-
Net Increase (Decrease) in Working Capital	$ (1,828)

Elements of Net Increase (Decrease) in Working Capital:	
Cash and Cash Equivalent	$ 2,174
Receivables	(86)
Accounts Payable	11,720
Inter-entity Loan Payable	(4,221)
Due to Other Accounting Entities	(9,674)
Liability for Compensated Absences	(1,741)
Net Increase (Decrease) in Working Capital	$ (1,828)

The notes to the financial statements are an integral part of this statement.

MONTANA AGRICULTURAL LOAN AUTHORITY

DEPARTMENT OF AGRICULTURE

NOTES TO THE FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDING JUNE 30, 1986

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Montana Agricultural Loan Authority is responsible for administering the activities of the Beginning Farm Loan Program and the Tax Deduction on Sale of Agricultural Land Program. These programs are designed to help private lenders assist beginning farmers and ranchers to acquire agricultural property.

A. Basis of Accounting

The financial statements were prepared from the Statewide Budgeting and Accounting System (SBAS) with adjustments. The authority utilizes the accrual basis of accounting for the Enterprise Fund. Under this basis, revenues are recognized in the accounting period in which they are earned and become measurable. Expenses are recognized in the period incurred, if measurable, and attributable to the program.

The Enterprise Fund is, by law, an appropriated fund. Fiscal years 1983-84, 1984-85, and 1985-86 were appropriated assuming the program personnel would work 100 percent on authority projects. Funds were not appropriated for rent and indirect costs. The expenses recorded on the accounting records reflect those appropriated while the accompanying financial statements reflect the actual expenses incurred by the authority.

B. Description of Fund

The fund presented and its relationship to the State Treasury Fund structure is as follows:

PROPRIETARY FUND TYPE

Enterprise Fund - To account for operations: (a) that are financed and operated in a manner similar to private business enterprises, where the intent of the Legislature is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the Legislature has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

C. Encumbrances

Encumbrances are recorded for purchase orders, contracts, and other commitments in order to reserve that portion of applicable appropriations for all funds. At fiscal year-end, in accordance with state policy, major qualifying encumbrances are reclassified as payables and charged as expenditures.

D. Inventories

Inventories consist of expendable supplies held for consumption. The cost is recorded as an expenditure at the time individual inventory items are purchased. The amount of supplies inventory on hand at June 30, 1986, was immaterial.

E. Insurance

The authority is insured through the Insurance Division of the Department of Administration.

2. EMPLOYEES' RETIREMENT SYSTEM

The authority's employees are covered by the Public Employees' Retirement System (PERS), administered by the state of Montana. Under PERS, the state contributes 6.417 percent of an employee's gross wages to PERS. All eligible employees contribute 6.0 percent of gross wages. The authority's contribution to PERS for the fiscal year ended June 30, 1986, was $699.

The state's policy is to fund accrued pension costs. The unfunded past service costs and the actuarially computed value of the vested benefits are not readily available for the members of the plan employed by the authority. The Public Employees' Retirement System was actuarially sound at June 30, 1985.

3. ANNUAL AND SICK LEAVE

Annual leave and sick leave costs are not recorded until leave is taken. Upon termination, qualifying employees with unused accumulated annual leave and sick leave receive 100 percent payment for annual leave and 25 percent payment for sick leave. As of June 30, 1986, the authority had a predicted liability of $1,741 for vacation leave and sick leave.

4. LONG-TERM NOTES RECEIVABLE, BONDS PAYABLE

The authority issued two bonds during fiscal year 1985 totaling $193,800. The bond proceeds were used to purchase the notes from the lending institution. These notes were then assigned to the lender as collateral for the bonds. The terms of the note and related bond are identical. Interest rates are variable on an annual basis.

Long-term debt and the related long-term notes receivable consist of the following as of June 30, 1986:

Bond Amount $81,600

8.75 percent bond payable. Note receivable in 20 annual installments of $8,781 (including principal and interest). Payments due beginning May 3, 1986. Principal outstanding at June 30, 1986 was $79,959.

Bond Amount $112,200

9.3 percent bond payable. Note receivable in 9 annual installments of $17,719 (including principal and interest). Payments due beginning May 3, 1986. Principal outstanding at June 30, 1986 was $112,200.

5. INTER-ENTITY LOAN

House Bill 447, Laws of 1983, gave authority for a General Fund loan of $97,969 for fiscal year 1983-84 and $99,325 for fiscal year 1984-85. The loan was to cover the authority's initial operating costs. House Bill 500, Laws of 1985, extended the repayment of the loan to June 30, 1987. The balance of the loan on SBAS at June 30, 1986, was $197,294. No payments on the loan have been made to date.

6. GOING CONCERN

The authority sustained an operating loss in fiscal year 1985-86 of $31,203. Consideration of the following additional factors raises the question of the continued existence of the authority.

1. No loans were granted during fiscal year 1985-86. It is believed that between $3 and $4 million in loans must be granted each year in order for the program to be self-supporting. Two bonds have been issued and one loan application is pending.

2. House Bill 500, 1985, extended the General Fund loan repayment date to June 30, 1987, but the loan will not be paid in full by that time.

3. Current economic factors in agriculture have contributed to the lack of development of the program. Federal legislation is pending that would facilitate that development, but the outcome of such legislation is uncertain.

4. During the first year of the authority, federal legislation related to the tax-exempt status of the bonds was pending. The authority's bond counsel would not offer a clean opinion on the authority's bonds until the issue was resolved, and thus program activity during the first year was halted.

5. The 49th Legislature of Montana enacted legislation allowing the state to guarantee agricultural loans, but no spending authority was provided.

7. PRIOR PERIOD ADJUSTMENT

The authority recorded its assumption of the liability for compensated absences in fiscal year 1985-86. This amounted to $2,234. The liability for compensated absences existed at June 30, 1985 and was not recorded. The authority recorded, in fiscal year 1985-86, $123 in depreciation expense which related to fiscal year 1984-85. A portion of the prior period adjustment, amounting to $31,488, reflects a correction related to improper recording of personal services expenses and indirect costs. Therefore, a re-statement of Retained Earnings at July 1, 1985, is reflected in these financial statements.